Government of Alberta

Submission to the House of Commons Standing Committee on Transport

August, 1983

The Western Canada Grain Transportation, Bill C-155

Alberta

INTRODUCTION

Alberta is pleased that the Standing Committee on Transport has met in Edmonton, prepared to make a conscious and determined effort to improve Western Canada's prospects for economic development and to encourage improvement and efficiency in the grain handling and transportation system.

Despite having many significant opportunities, Alberta's economy faces an ongoing challenge — transportation. The province is located farther from tidewater, without direct water access, than most of its world competitors. In order for Alberta to compete effectively, the province requires the most cost-efficient and productive transportation system possible. No other challenge has similar implications for Alberta or Western Canada, and unless this transportation challenge is soon met, opportunities and associated economic benefits may be lost.

Agricultural Profile

Primary Production

With more than 50 million arable acres, Alberta has approximately 30 percent of Canada's farmland. Each year, additional land is brought into production through land clearing and breaking. It is estimated that another 10-20 million acres in Alberta could be brought under cultivation.

The trend in Alberta, as in all of Canadian agriculture, is to larger farms through consolidation. Technological change now allows producers to successfully operate considerably larger farms than was possible 20 years ago. In addition, total crop production has increased sharply over the same period. Farmers in Western Canada produced nearly 20 million tonnes of crop products in 1961. By 1981, this total had risen to more than 60 million tonnes. Crop production from Alberta alone accounted for 24 percent of the Canadian total in 1981.

Increases in livestock production have also been significant. Alberta's share of national cattle and calf production has increased substantially from 1961 to 1981. Producers in Alberta maintain nearly one-half of Western Canada's cattle and calves, or one-third of the Canadian total.

In contrast to cattle, Western Canada's share of hog production has declined from 48 percent in 1961 to 29 percent in 1981, even though the national herd grew by 320,000 head. Hog production in Alberta has experienced the same decline. Alberta's share of Canadian pork production dropped from 20 percent in 1961 to 12 percent in 1981.

Farming in Alberta is big business today. Alberta and Canadian farmers compete on world grain markets and on a North American livestock market. Alberta's primary agricultural exports have been estimated at more than $2 billion per year.

Processing

Food processing ranks third in Alberta's manufacturing sector, contributing more than $3.5 billion annually to the Alberta economy. Animal slaughter and meat processing represent approximately one-half of this value, while dairy and oilseed processing each constitute 10 percent.

Commodity processing in Alberta is dominated by meat processing companies which ship more than 80 percent of their output out of the province. Another major component of Alberta's processing sector is oilseed processing, involved mainly with crushing canola seed into oil and high protein meal. Although Western Canada exports canola oil and meal to foreign countries, Central Canada is the province's major market for canola oil.

A greater processing capability is gradually developing within the province. However, many companies lack the technical, financial and the managerial skills possessed by firms in proximity to major population centers. Despite these drawbacks, Alberta firms provide top-quality, innovative products which trade on international markets.

History of the Statutory Rate

The Crow's Nest Pass Agreement

As early as 1849 a transcontinental railway was advocated to help settle the Prairies and to bind Central and Western Canada into one economic and political union. When British Columbia entered Confederation in 1871, it did so on the condition that a rail link would be built between Eastern Canada and the Pacific Coast. This provided the impetus for construction of a transcontinental railway.

In 1881, the Government of Canada entered into an agreement with the Canadian Pacific Railway to build the transcontinental line by 1891, and to keep it in efficient operating condition thereafter. As

part of the agreement, the railway would be allowed to earn up to a 10 percent return on its investment without the federal government exerting control over its freight rates. The railway was completed in 1885, thanks in part to subsidies and grants provided by the Dominion Government as well as private investment supplied by the CPR.

From the early 1880's, British Columbia's Kootenay region was known to be rich in mineral resources. Due to limited access, development had been slow. The natural access point to the area was Spokane, Washington. The desire to exploit the Kootenays' economic potential, combined with apprehension about potential American influence, created an environment conducive to the federal government subsidizing a Canadian rail line to the region.

The CPR received a grant of $11,000 per mile to build a rail line from Nelson, B.C. to Lethbridge, Alberta and agreed to fixed limits on rates for a short, prescribed list of commodities, thereby forestalling the general rate regulation sought by the federal government. This was the Crow's Nest Pass Agreement of 1897. This agreement stimulated regional economic development and at the same time gave the federal government some control of CPR rates, which the 1881 Agreement had specifically precluded.

The 1897 Agreement set out a number of provisions and obligations. Of primary importance was the establishment of a ceiling on rates for specified westbound goods and a 3¢ per cwt. reduction on eastbound grain and flour from all points west of the Lakehead. As required, the CPR reduced grain and flour rates over the next two years, the final reduction taking effect in September 1899.

Almost immediately, the Crow Rates were subjected to change. Responding to lower grain rates charged by the Canadian Northern Railway, the CPR lowered its rates by 4¢ per cwt. below the rate limit set in the Agreement. In 1918, the federal government, under the authority of the **War Measures Act**, allowed CPR rates to rise above the agreed limit. Following the war, rapid inflation prompted the federal government to allow the freight rate on grain and flour to continue to rise.

The Rate Becomes Statutory

The recession of 1921 depressed grain prices dramatically, resulting in a general call from the West for a return to the terms of the Crow's Nest Pass Agreement. The CPR was unwilling to lower its rates. Parliament, however, reaffirmed the Agreement. The Crow Rates became effective again in 1922, with the exception of the higher rates for westbound goods which were extended to 1924.

When the suspension ended, the CPR argued that the Crow Rates should apply only to those points which existed at the time of the 1897 Agreement. The Supreme Court of Canada confirmed this interpretation, but the federal government viewed the implications as politically unacceptable. Thus, in 1925, Parliament made the Crow Rates statutory requirements under the Railway Act and extended their application to all delivery points for all railways from the Prairies to the Lakehead. The Crow Rates had become the Statutory Rate.

More changes were to come. Shipments through Vancouver became eligible for the Statutory Rate in 1927. Churchill shipments became eligible in 1931. At various times since, additions have been made to the list of commodities moved under the Statutory Rate. The most recent addition was made in 1961 when rapeseed (canola) was defined as a "grain".

These piecemeal additions have resulted in a number of anomalies in the present Statutory Rate structure. These anomalies include the different costs for shipping raw oilseed versus its processed products and different transport costs for shipping rapeseed meal east to Thunder Bay versus west to Vancouver. There are also different transport costs for shipping other grains. Published Statutory Rates contain at least 330 freight rate anomalies i.e. not distance related.

Statutory Rate Reviews

Over the years, the impact of the Statutory Rate on the Prairie economy has been extensively examined. The MacPherson Royal Commission of 1958 found the railways were losing money transporting grain at the Statutory Rate. MacPherson recommended the federal government retain the Statutory Rate in the public interest and pay a subsidy to the railways to compensate for losses incurred. Although the full provisions of the recommendations were never carried out, the MacPherson Commission recommendation that a branchline subsidy be paid for lines on which the railways were losing money was enacted.

Subsequent studies by Hall and Snavely also found that railways' revenues were not adequate to cover the costs of moving grain. The Hall Commission took into account more than the financial losses of the railways. In addition to recommending a subsidy to the railways for moving grain, the Commission recommended subsidizing the movement of processed products from Western Canada in order to neutralize the distortions and disincentives the Statutory Rate was having on value-added processing in the agricultural sector. Due to its tremendous cost, this recommendation was not accepted by the federal government.

Rail Investment Problems

During this time, the railways did not passively accept their losses on grain transportation. Until the 1950's, they had shown little interest in rationalizing their branchline networks. However, increasing costs forced the railways to consider cost-saving measures, one of which was the abandonment of light density rail lines.

Although the federal government accepted the recommendation of the MacPherson Commission and paid a subsidy for branchline operations, minimal amounts were reinvested in the branchline system. The lines were allowed to deteriorate. Eventually, this led to the introduction of a federally-funded branchline rehabilitation program in 1977. Even so, the capability of the railways to effectively serve the grain industry in Western Canada was being steadily eroded.

This deterioration in service due to a lack of railway investment in branchlines was compounded by the railways foregoing investment in rolling stock. Over time the situation became so critical that the federal government, and, more recently, the Western provincial governments were forced to purchase grain hopper cars.

The last 10 years have seen an explosion in economic activity in Western Canada. For the most part this has been resource-based, relating to conventional oil and gas, oilsands, agricultural commodities, coal, sulphur, petrochemicals, potash and forest products. As a result, when the West required increased rail capacity to move bulk commodities, the system was found to be inadequate. Rationing rail capacity among users became a very real prospect. It was this prospect and the realization that economic development could not proceed without an efficient and adequate rail transportation system that provided the stimulus for the renegotiation of the Statutory Rate structure.

Events Leading to Bill C-155

The Snavely Commission

In 1975, the federal government appointed a Commission of Enquiry to conduct an independent analysis of the costs of transporting grain and grain products whose rates were set by federal statute. The Commission concluded that revenues received by the railways for transporting grain were not adequate to cover variable costs.

The Hall Commission

Concurrent to the Snavely Commission, the federal government announced the formation of a Commission to examine, evaluate and make recommendations on the disposition of certain branchlines. Interpreting his mandate in the broadest sense, Justice Emmett Hall examined the entire grain handling and transportation system. While the Commission's primary focus was the issue of branchline abandonment, the Commissioners recognized the inadequacy of railway compensation and the distortions in value-added processing which stemmed from the Statutory Rate.

The National Energy Program

A prime objective of the National Energy Program was to capture a greater share of oil and gas revenue for the federal government. In return, the federal government was committed to address both the particular endowments and challenges of the West, and issues of long-standing Western concern. The federal government indicated that a significant portion of their actions would involve funding for infrastructure improvements, industrial development, and diversification and agricultural programs. The objective would be to encourage the type of diversified growth that Westerners believe should take place in the West.

WESTAC and Coal Association Meetings

In 1981, WESTAC and the Coal Association held meetings to discuss the impending rail capacity shortfall. These groups concluded that by 1985 there would be insufficient capacity to the West Coast to move projected volumes of freight due to the railways' underinvestment in infrastructure. This was linked to inadequate revenues received by railways for transporting grain. The meetings recognized that a rail capacity shortfall could result in a prioritization of rail traffic. Statutory grains would likely be last in a priority ranking and thus Western Canada's international reputation as a secure supplier of grains would be at risk.

The Federal Government's February 1982 Policy Statement

Discussions within Western farm organizations regarding implications of a Statutory Rate change were perceived by the federal government as indicative of a consensus on the mood for change. The federal Policy Statement of February 1982 set out certain principles that a new Statutory Rate structure would have to address. At this time the federal government appointed Dr. Clay Gilson to consult jointly with Western farm groups and the railways on the best way to fulfill these principles.

Following meetings in Winnipeg with farm groups and the railways, Dr. Gilson submitted extensive recommendations to the Federal Transport Minister in June of 1982. The policy framework presented by Dr. Gilson represented a significant compromise for most farm organizations.

The Western Transportation Initiative

On February 1, 1983, the Federal Minister of Transport announced the Western Transportation Initiative.

"The Government expects that its decisions will provide a major stimulus to economic development in the 1980's and beyond, as a result of:

1. Major investment programs by the railways stemming from the new system to compensate them for moving grain;
2. The reduction in distortions in the western agricultural economy, which should result in more processing, livestock production and crop diversification;
3. Additional measures to promote agricultural development across Canada, and to enable industries and producers in the West to take advantage of the opportunities presented by the major expansion of the western railway system."

The Western Transportation Initiative did not fully meet Alberta's principles; however, it was viewed as a necessary first step toward continued agricultural growth and economic development.

ALBERTA'S OBJECTIVES

The Alberta Government is deeply committed to improving Canada's grain transportation and marketing system.

The Alberta Government has made significant efforts to improve the system by providing up to $240 million in financing for the Prince Rupert grain terminal, purchasing 1,000 hopper cars for use throughout Western Canada and purchasing and upgrading three inland grain terminals. Combined with joint federal-provincial efforts in nutritive processing, these activities highlight Alberta Government's ongoing commitment to improve grain handling and value-added processing in Western Canada.

The Alberta Government has maintained a consistent position on these needs for the last decade. Each proposal or initiative, including Bill C-155, has been evaluated in light of the Province's grain transportation policy. Central to this policy is recognition of the need for a successful resolution of the Statutory Rate issue. The Province's guiding principles in developing their position with respect to Statutory Rate change have been:

- retention of the "Crow Benefit" for farmers;
- removal of disincentives to value-added processing;
- improvement in rail capacity and efficiency;
- provision of adequate revenue for railways relative to costs of moving grain;
- legislated and regulated rate formulas.

These principles reflect the complex and interrelated nature of the issues to be considered in the development of a comprehensive grain transportation policy. Sufficient rail capacity is essential to the Alberta Government's goal of economic development. However, investment will occur only if the railways are adequately compensated. Alberta's agricultural processing industry requires a freight rate structure that does not discriminate between the export of raw grains and products processed from those grains. While it is generally recognized that farmers should pay a share of the cost of grain transportation, they must not be required to give up the Crow Benefit.

There is a noteworthy similarity between the Alberta Government principles and the federal government's policy objectives. Farm organizations across Western Canada have generally accepted criteria similar to the Government of Alberta. In particular, commodity groups, farm organizations, crushers and grain companies have accepted that the Statutory Rate is a disadvantage to local value-added processing.

BILL C-155

In the 1982 and 1983 policy statements on Western rail transportation, the federal government announced objectives that formed part of a broad Western transportation policy. These objectives are not met by Bill C-155.

As such, Bill C-155 has major deficiencies which will render it ineffective in meeting the needs of agriculture and economic development in Western Canada.

First, Bill C-155 lacks both major guiding principles and a statement of policy. These must be included if the specific measures proposed in the Bill are to be relevant to longer-term goals and the results achieved are to be subject to valid evaluation.

Second, the Bill's critical shortcoming is that it does not address the opportunities for economic diversification in Western Canada. The Bill does nothing to ease or to correct distortions and disincentives associated with the Statutory Rate. In fact, raw products and jobs will continue to be exported from Western Canada. This is not acceptable.

Third, Bill C-155 ignores the comprehensive approach required to resolve grain transportation issues. Rather, it addresses transportation capacity on an ad hoc basis. This is a stop-gap measure which most responsible parties have rejected as a long-term solution. Funds should be directed toward two ends: increased rail capacity and improved grain system efficiency and performance.

Fourth, the Bill does not adequately address producers' concerns regarding their ability to pay. Grain producers are already caught between depressed prices and rising costs. It is unacceptable to place another burden on them. Immediate producer protection must be included in the legislation.

In addition to the fundamental shortcomings of Bill C-155, there are a number of important technical concerns and omissions in the proposed legislation. Appendix I provides documentation and discussion of each of these. The following provides elaboration on the major deficiencies in Bill C-155.

Lack of Purpose

Any Act "to facilitate the transportation, shipping and handling of western grain ..." should be consistent with the broad policy established in the **National Transportation Act**. Bill C-155 does not include a separate statement of policy nor does it reflect the objectives of the Western Transportation Initiative. A clear statement of policy and related principles included in the Act is a necessary guide for effective regulation and interpretation of Parliament's intentions.

Economic Distortions

The Statutory Rate acts as a disincentive to value-added processing in Alberta by increasing input costs. Local grain prices are derived from the port price minus the cost of transportation and handling. Since the cost of transportation is artificially low under the Statutory Rate, local livestock producers and processors pay a price for their grain inflated by as much as the gap between the true cost of transportation and the Statutory Rate, particularly when supplies are short.

Additional distortion has resulted from occasional surplus stocks of feed grain on the Prairies. This has, from time to time, depressed local feed grain prices. This in turn amplifies the year-to-year price fluctuations and creates an additional source of uncertainty for livestock producers and processors. These high stock levels can be attributed to a combination of two factors: lack of service by the railway, and the Canadian Wheat Board's performance in export sales.

The Government of Alberta believes that removing these economic distortions is essential. The domestic grain pricing distortion stemming from the Statutory Rate affects both the primary and secondary levels of Alberta's agricultural industry. Through Bill C-155, the federal government has decided to continue economic measures which exacerbate this distortion, particularly in the livestock sector.

The federal government's February 1, 1983 policy decision, the Western Transportation Initiative, suggested a solution to the distortion problem.

> "A system of payment to producers would provide increased scope for economic decision making by individuals and, in consequence, give more play to marketing forces. Of particular importance is that it would reduce existing economic distortions and, in the medium term, should lead to growth and efficiency in the grain transportation system."

Under Bill C-155 the entire Crow Benefit would be paid directly to the railways; thus the published freight rate for grain will remain below the true cost of transporting grain. The Government of Alberta must therefore conclude that the Federal Government has abandoned its objectives to reduce existing economic distortions and to improve growth and efficiency in the grain transportation system.

A Federal Government study (Agriculture Canada, **Agriculture Impacts of Crow Change – Final Report**, February 1983) concluded that if the majority of the Crow Benefit were paid to farmers, annual agricultural production in Western Canada could increase by as much as $1 billion by 1990. This figure does not include increases in value-added processing. The study also concluded that a market-neutral payment to Western farmers would have little or no impact on producer income in Central and Atlantic Canada. The Government of Alberta estimates that net income in Alberta's livestock industry alone will be reduced by $300-400 million by 1990-91 if the railways receive the Crow Benefit directly.

Additional distortions will arise if the Crow Benefit is paid directly to the railways. Producers of crops ineligible for the new rate structure will be at a competitive disadvantage as they will face lower returns after paying full market freight rates. The result is a bias towards the production of grains eligible for the new rate. As well, farmers' choice of transportation modes for moving grain will be biased in favour of rail. Therefore the opportunity for a multi-mode approach to grain transportation will be denied.

In summary, the method of paying the Crow Benefit proposed in Bill C-155 denies both Western farmers and investors access to agricultural and economic development opportunities and restricts the development of new transport options. In turn, this reduces the potential for economic and agricultural development which may cost Canadians thousands of future jobs.

Double 80

The Government of Alberta and major farm organizations developed a proposal to reduce domestic grain pricing distortion and dilution of the Crow Benefit by a system of payment that addresses both anomalies. The proposal has not been supported by all organizations at the delegate level; however it is a viable approach for payment of the Crow Benefit to producers, and it is supported by a substantial number of farm organizations in Alberta and in other provinces as well.

An important element of this proposal is that regardless of the payment method the farmer chooses, the railway must publish a compensatory rate for all shipping points. This would help remove grain pricing distortion.

Two key factors were considered. First, it was agreed that payment of the Crow Benefit directly to the railways would not significantly reduce distortion.[1] To reiterate, Alberta grain prices are established on international markets and are fundamentally related to the price of grain in export position less the cost of transportation. Since grain transport costs have been kept artificially low due to the Statutory Rate, local grain buyers pay artificially high or distorted grain prices.

Second, it was agreed that proposed methods for paying the Crow Benefit to all producers caused a dilution[2] effect. Dilution would result because a larger volume of grain would become eligible for the Crow Benefit. Since the Crow Benefit currently applies only to grain shipped under the Statutory Rate, increasing the volume of grain eligible for the Benefit would dilute the Benefit for producers shipping under the Statutory Rate.

The proposal, referred to as "Double 80", encompasses a direct payment to the railways or, if the farmer chooses, a direct payment to the producer.

In keeping with the February 21, 1983 Western Transportation Initiative, the $204 million in Agricultural Adjustment Payments should be provided by the federal government between 1983-84 through 1985-86. These payments would further offset the dilution effect.

Figure 1 presents the proportion and distribution of the Crow Benefit under "Double 80". A description of the figure is as follows:

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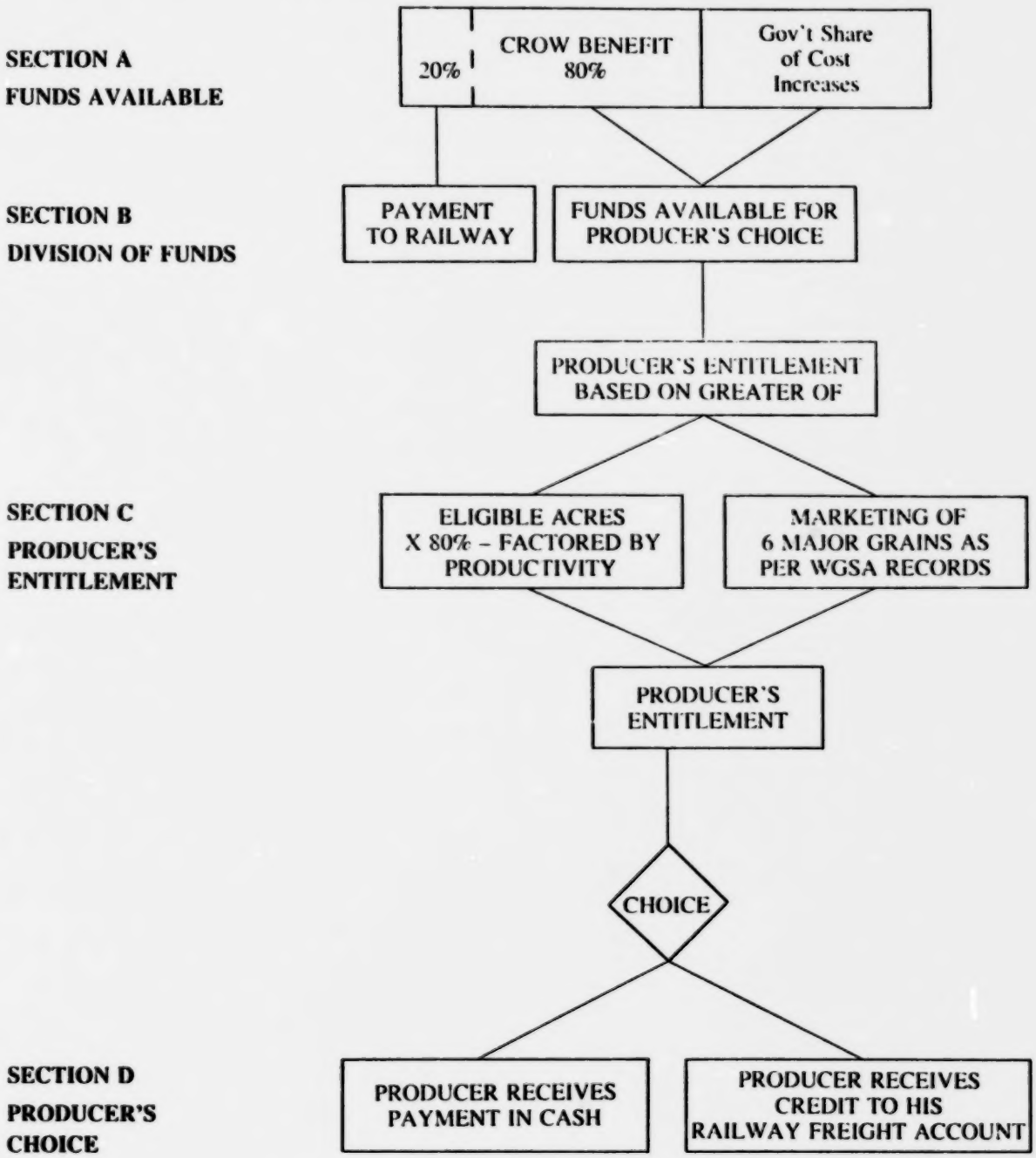
[1] Distortion
– an artificially high price for feed grain on the Prairies caused by an artificially low freight rate (Statutory Rate) to the port.

[2] Dilution
– a reduction of the share of the Crow Benefit originally accruing to exported grains, caused by sharing the Crow Benefit with all grains.

Figure I

"DOUBLE 80"



Funds Available (Section A)
- The total funds available for disbursement include the Crow Benefit plus the Federal Government's share of future cost increases.

Initial Division of Funds (Section B)
- 20 percent of the Crow Benefit would be paid directly to the railways.
- 80 percent of the Crow Benefit plus the Federal Government's share of cost increases would be funds producers could choose to assign directly to the railways through a freight account or have paid directly to themselves.

Producer's Entitlement (Section C)
- An individual producer's entitlement would be the greater of two independent calculations. One calculation would be based on acreage, the other on actual marketings.
- Both calculations would be converted to a tonnage basis.
- The acreage calculation would be 80 percent of an estimated production level. The production level would be derived by multiplying an individual's eligible acreage by a productivity factor.
- The marketings calculation would be the sum of actual shipments of wheat, oats, barley, canola, rye and flax marketed under the Western Grain Stabilization Act during a crop year.
- The producer's entitlement would be the greater of these two tonnages multiplied by the per tonne entitlement ($/tonne).
- The producer could assign his entitlement either to himself as a direct payment or to the credit of his railway freight account. If he received the payment directly, he would be obliged to pay the higher freight rate at the elevator.
- If the producer assigned his entitlement to his freight credit account, the credit would be reduced as he delivered grain to the elevator. Any credit remaining in an account at the end of the crop year would be paid directly to the producer.

Grain Transportation System — Investment, Performance and Efficiency

It is fundamental that in return for adequate compensation the railways be required to provide meaningful investment, performance and service guarantees. The new legislation must also promote efficiency and economy throughout the grain handling and transportation system. Bill C-155 does not adequately address these needs.

Investment

Bill C-155 will give substantial public funding to national corporations whose investments are veiled from public view. The Province is concerned with the lack of measures in Bill C-155 which would guarantee railway investment in sufficient rail capacity.

To address this concern, Bill C-155 should be amended to require that the railways publish annual statements of source and application of funds and a schedule of future investment intentions.

Performance

Under the administrative measures of Bill C-155, farmers' interests are not adequately represented. In essence, decision making power lies with the federal government, specifically the Minister of Transport, Minister of Agriculture, and the Minister Responsible for the Canadian Wheat Board.

Bill C-155 will increase the farmers' cost of transporting grain in the future. However, the Bill does not provide a suitable mechanism for farmers to influence system performance and efficiency. Farmers should take part in the process of negotiating targets and developing the system of awards and sanctions.

Consequently, the Senior Grain Transportation Committee should be structured so that a majority of members represent Western farmers. Furthermore, a system of awards and sanctions with respect to meeting performance objectives should be instituted as soon as possible.

Efficiency

Under Bill C-155, rules and regulations will continue to replace normal pricing signals in allocating transportation resources. Such regulation of the system will not allow the pricing mechanism to reflect new efficiencies. Only the federal government will be in a position to benefit from future railway cost savings. There is no incentive for farmers or grain companies to invest in improvement and expansion of the grain system as there will be no sharing of cost savings.

In addition, in the grain handling and transportation system decision making is separate from funding responsibility. If the system is to work efficiently and be accountable, there must be a clear delegation of authority. In all other major transportation systems a "shipper" represents user needs. Bill C-155 recognizes this shortcoming and establishes a 21-member committee. Unfortunately, the committee is weighted heavily toward those groups and organizations who have a vested interest in the status quo and has no delegated authority to ensure system performance. A "shipper" must be designated to be responsible for farmers' interests by dealing with railways in establishing freight rates and coordinating shipments. Under Bill C-155 the most appropriate person to fulfill this function would be the Grain Transportation Administrator.

The combination of an agent responsible for their interests and the ability to choose to receive the Crow Benefit directly allows farmers to influence system efficiency.

Ability to Pay

The total cost of grain transportation will be shared between the federal government and Western grain farmers. Farmers do not have the same ability as the federal government to increase their incomes or to deficit finance. In marketing agricultural commodities, the farmer must accept whatever the market offers.

The railways have been essentially guaranteed the cost of transporting grain. Each year, regardless of tonnage hauled and commodity value, the railways' costs for moving grain will be calculated and a rate established to cover those costs.

Forcing producers to bear the first 6 percent of future cost increases without considering their ability to pay does not appear to be an equitable sharing of rail cost increases. As there is doubt that farmers will be able to pay higher freight rates, Bill C-155 should provide for a 4.5 percent limit on the producers' share of future cost increases for the period after 1985-86. Future reviews would then determine if the limit should be altered.

The Government of Alberta is also concerned with the limitations placed on grain shipments eligible for the Crow Benefit. Farmers will have to bear all costs for grain shipments in excess of 31.1 million tonnes. It has been projected that this level will be exceeded in the 1982-83 crop year. It is a contradiction to charge more for extra production when the goal is to increase export sales.

The Safety Net

To protect against financially burdensome freight rates, the federal government has indicated a willingness to consider a "safety net" provision that would limit farmers' exposure to the risk of higher freight costs vis-a-vis grain returns. The federal proposal is to have freight charges limited to 10 percent of a weighted average price for a "basket" of western grains. This limit would represent the historical relationship that freight rates have had with grain prices, thereby maintaining farmers' traditional costs/returns ratio insofar as transportation is concerned.

An alternative safety net is recommended for consideration. This alternative is consistent with the railways' value-of-service pricing used for captive shippers. Such a system would recognize the need to place a ceiling on the contribution grain shipments would make to railway constant costs.[3] In years where grain prices drop dramatically, the grain freight rates charged the producer would decline, but not below railway variable costs.[4] Conversely, in years when grain prices are high, the rates would reflect the full contribution to constant costs allowed the railways.

The construction of a safety net based on value-of-service pricing has a number of advantages. Most important, it would provide lasting protection to farmers. Proposals calling for grain rates to remain at a fixed percentage of grain prices could become a growing financial burden on the federal government. As such, they might be eliminated, leaving the farmer unprotected. A second important advantage is that this form of safety net can take effect immediately.

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[3] Constant costs – costs which ordinarily do not vary with increases or decreases in traffic e.g., ownership and maintenance of tunnels, bridges, culverts, snow sheds and snow removal and corporate services such as legal and policy departments.

[4] Variable costs – costs incurred as a result of and attributable to the movement of identified blocks of traffic e.g., fuel, labor, cost of capital, and roadway maintenance.

Comprehensive Reviews

Given the significant changes that are to be made in the legislative, administrative and financial arrangements for grain transportation, a recurring review process is essential.

The Government of Alberta supports the need to carry out a comprehensive review of the implementation of Bill C-155, along with its effects on the transportation, shipping and handling of grain. Careful consideration must be given to the timing and methodology used in evaluating the effects of this Bill. Realistically, adjustments within the industry will occur gradually.

The Government of Alberta believes that it is necessary to hold reviews at 5-year intervals to ensure the new legislative framework is working in the best interests of Western Canadian farmers and others who depend on the grain transportation system. Furthermore, the process must be expanded to include all federal acts, institutions and regulations which govern or regulate the operation of the grain system.

SUMMARY OF AMENDMENTS

The process which culminated in the introduction of Bill C-155 required significant compromises by all parties. In this spirit of compromise it has been possible to build a significant degree of consensus on the need for change in the Statutory Rate and the need to meet the objectives originally proposed by the federal government.

Major improvements to Bill C-155 are required if Alberta's agricultural sector is to realize stability and achieve its growth potential. Outlined below are nine basic amendments to Bill C-155 which the Government of Alberta maintains will encourage grain transportation efficiency and economic development in Western Canada.

1. **Statement of Policy**
   Bill C-155 should be amended to include a statement of policy based upon the objectives put forth in the federal Western Transportation Initiative of February 1983.

2. **Payment Mechanism**
   Producers should be allowed to decide the method by which they receive the Crow Benefit and the federal share of cost increases.

3. **Grain System Performance**
   The Senior Grain Transportation Committee should be restructured so that a majority of the members represent Western farmers and are free from vested interest in the grain handling/transportation system.

4. **Grain System Efficiency**
   The Grain Transportation Administrator should act as a "shipper" with sufficient authority to act on behalf of farmers.

5. **Grain System Investment**
   The railways should be required to publish annual detailed statements of source and application of funds and investment intentions.

6. **The Safety Net**
   A "safety net" based on value-of-service pricing should be instituted.

7. **Future Cost-Sharing**
   Farmers' share of inflation should initially be limited to 4.5 percent.

8. **Limitations on Shipments**
   The federal government's Crow Benefit limit of 31.1 million tonnes should be removed.

9. **Reviews**
   A review of all federal acts, institutions and regulations which govern the operation of the grain system should be undertaken every five years.

Appendix I

RECOMMENDED CHANGES IN BILL C-155

Section – Preamble

Amendment – A clear statement of policy and related principles should be included in a preamble to the Act.

Discussion Bill C-155 as it is now written does not contain a statement of policy and is in conflict with stated National Transportation Policy.

- The policy statement should include the objectives outlined in the February 1983 Western Transportation Initiative statement. These objectives were:
  - to ensure adequate overall railway capacity in Western Canada;
  - to develop a modern and efficient grain transportation system;
  - to encourage economic development and agricultural diversification and processing in Western Canada; and
  - to contribute to national economic recovery through economic activity generated by railway expenditures and associated developments. (This should be considered as only a short term goal.)
- A policy statement is necessary as an effective guide for regulators and those who are responsible for interpreting the intent of the Act.

PART I

ADMINISTRATIVE MEASURES TO FACILITATE THE TRANSPORTATION, SHIPPING AND HANDLING OF GRAIN

Senior Grain Transportation Committee

Section 3 – Membership of Committee

Amendment

- The Senior Grain Transportation Committee should be restructured so that a majority of the members represent Western farmers and are free of vested interest in the grain handling/transportation system.
- Delete clause 3(d)(ix) which calls for three members to represent the interests of feed grain consumers.

Discussion

- The proposed committee structure is weighted too heavily toward those groups and organizations who have a vested interest in the status quo.
- The grain farmer who has the responsibility to pay future cost increases is not adequately represented. The Crown is well represented through the Canadian Wheat Board, Canadian Grain Commission and the Administrator; the trade interests are covered through their appointed representatives, the railways' interests through their representatives but direct grain farmer representation is restricted to 3 out of the total 21 memberships.
- There is no need for either Eastern or Western feed grain users to be represented on a transportation committee.

Section 11 – Subcommittees and Rules

Amendment – Section 11 should be expanded to permit the Committee to form "technical" subcommittees which may be composed of individuals designated by members of the Senior Grain Transportation Committee. These subcommittees would have the same rights as the main committee including the right to obtain confidential cost data.

Discussion – Responsibilities of the Senior Grain Transportation Committee include a number of areas which are highly technical in nature. For example, the car allocation system, input to costing reviews, etc. To ensure the Committee is able to fulfill its role, its members should be able to utilize the resources available to them, be it technical staff or independent consultants.

Section 12 – Duties and Functions

Amendment – Add after 12(a)(iii) a clause (iv) which instructs the Committee to review the authority and responsibility for the functioning and operation of the grain handling and transportation system.

Discussion – Bill C-155 fails to define the "shipper" in the grain system. This shortcoming was apparently recognized and the 21 member committee was established as a substitute for a defined shipper. In all other major transportation systems it is clear who is accountable for the performance of the system.

– If the grain handling and transportation system is to become more efficient, then its authority and responsibility needs to be clearly assigned and delegated. We recommend the Grain Transportation Administrator be designated to sit on behalf of farmers as the "shipper".

– The Bill relies heavily on the use of awards and sanctions. If this system is to work there must be a clear delegation of authority and responsibility throughout the grain system.

Section 17 – Duties and Functions

Amendment – Strengthen Sect. 17(1)(f) by deleting "identifying means of."

Discussion – This clause should reflect the clear intention of the Government to strengthen the role of the Administrator in the grain system.

Clause 18(1)(c) – Duties and Functions

Amendment – Following the phrase "on the basis of tonnage" add "or on any other basis found to be reasonable."

Discussion – The Act need not limit performance objectives to a tonnage basis. Most objectives can and should be expressed in tonnage units but there is no need to limit the options at this time.

Clause 18(2) – Where Regulations in Force

Amendment – Clarify the jurisdiction of the Administrator over the grain handling aspects of the system.

Discussion – The authority of the Administrator vis-a-vis the Canadian Grain Commission has not been defined.

– Is this Act sufficient to give the Administrator power to apply sanctions to all participants, e.g. the Canadian Wheat Board?

Amendment – Identify the source of funding for awards and sanctions for participants other than the railways.

Discussion – The Administrator does not have a source of funds which can be used to award or penalize participants other than the railways.

Clause 20(2) – Implementation of Changes

Amendment – The Committee should be given 30 days to approve or refuse a proposed change. If the Committee fails to agree, the issue may be referred to the Minister or his appointee for a decision.

Discussion – The Committee must play a greater role in the implementation of change in the system. As it is now worded, this clause would allow the Administrator to ignore the Committee, particularly on matters where there is some disagreement. Since some disagreement is inevitable there needs to be a mechanism for resolution of disputes.

Sections 21-28 – Performance Objectives Regulations

Amendments – The development of the system of awards and sanctions should be assigned to the Administrator.

– The Administrator would invite input from interested parties and hold hearings if deemed necessary.

– Any appeals concerning the system of awards and sanctions could be made to the Canadian Transport Commission.

– The development of a system of awards and sanctions should commence within six months of the passage of the Act and be completed six months thereafter.

Discussion – The development of a system of awards and sanctions is important but very difficult. To place this task before Parliament would invite delay, make changes difficult, and limit the opportunity of those affected to be heard.

– As the intent is to apply awards and sanctions to all participants, there is a need to ensure this Act is sufficiently powerful so as to eliminate the problems of overlapping jurisdictions.

– It is important that the development of this system commence as soon as possible. However, it must be recognized that the clarification of authority and responsibility in the system is an essential first step (See Section 12).

Section 29 – Annual Statement to be Submitted

Amendment – This section should require that railways publish annually a detailed statement of source and application of funds.

Discussion – Since neither the CNR or the CPR are separate corporate entities, the investment transactions of the railways are veiled from public view. With the passage of Bill C-155, the railways will receive massive infusions of public funds. The public has a right to know how these funds are utilized. It is recognized that the Committee will require access to confidential information to fulfill its monitoring role as laid out in this Section. However, there is a legitimate need for public disclosure regarding the disposition of public funds.

Clause 30(1) – Investigation

Amendment – A review of the car allocation system should be conducted jointly by the Senior Grain Transportation Committee and the Administrator.

Discussion – Section 12(a) also contains a provision for the Committee to review the car allocation system. Therefore,any such reviews should be coordinated between the Committee and the Administrator. The suggested amendments in Section 20 should also apply in this case to ensure that participants in the system play a greater role in shaping future changes.

PART II

RATES

Section 34 – Crow Benefit

Amendment – The definition of the "Crow Benefit" be augmented by the inclusion of the "Agricultural Adjustment Fund."

Discussion – This brief proposes Double 80 which suggests inclusion of the "Agricultural Adjustment Fund", identified in the Gilson process in order to avoid dilution of the Crow Benefit to producers. However, there should be no phasing out of the "Agricultural Adjustment Fund" as Gilson proposes. This is tantamount to removing the Crow Benefit from farmers, especially those whose emphasis is the export market.

Section 38 – Costing Reviews

Amendment – The periodic costing reviews should be conducted in public.

Discussion – These reviews will directly impact on farmers' costs and as such should be done in public. In addition, the commission should be required to produce a report comparable to those prepared by Carl Snavely to support their findings.

Clause 38(2)(a)

Amendment – The costing review should clearly separate costs incurred from costs not incurred.

Discussion – The present wording of this section encourages railways to identify future costs which they may or may not incur. Claims for costs not incurred by the date of the review should specifically be estimated and then monitored by the Commission under provisions of Section 29(2).

– In addition future savings should be identified in order to have these reflected in the future cost estimates.

Clause 38(2)(b)

Amendment – Delete, "in accordance with paragraph 276(3)(b) of the Railway Act."

Discussion – Section 38(2) of Bill C-155 specifies that the cost of capital rate for CN be set equal to the cost of capital rate set by the CTC for CP Rail.

– There are a number of problems with this section. First, it is the only part of S.276 of the Railway Act (Minimum Rate Provision) which is to be applied to grain; all other parts of S.276 are exempted (see S.34(2) of Bill C-155). Second, since the cost structures of CN and CP are different for other cost categories it is inconsistent to make the cost of capital component equal between the railways. In fact, there is at present a large difference in the cost of capital between the carriers primarily as a result of CN not being in a taxable position. Third, in the 1979 "Income Tax Decision", the CTC prescribed different cost of capital rates for CN as opposed to CP for purposes of branch line subsidy applications. Fourth, the whole question of the appropriate cost of capital rate is currently under review by the CTC.

Clause 38(2)

Amendment – Add a clause (f) which instructs the Commission to reduce the cost base by the costs associated with any ancillary charges assessed by the railway.

Discussion – Bill C-155 does not preclude the railways from assessing ancillary charges such as stop-off charges on the movement of grain. It is therefore important that the costing review carefully develop the cost base in order to ensure the costs associated with activities for which ancillary charges are assessed are excluded from the rate base.

Clause 39(2) – Estimated volume related and line related variable costs.

Amendment – The Commission should publish a report explaining the results of its annual estimation and adjustments.

Discussion – Farmers will be paying a large portion of any increase and as such should be presented with sufficient information to allow them to understand the rationale behind the annual increases.

Clause 39(2)

Amendment – Estimates of costs and volumes should be audited annually.

Discussion – Between Costing Reviews, adjustments to the rates will be based on estimates of costs and volumes. This exercise should be supplemented by an annual audit comparing revenue received and costs incurred. Deviations should be investigated in order to improve subsequent years' estimates.

Sections 41-53 – Tariff of Rates

Section 41 – Rates

Amendment – After the word "rates" add "conditions of carriage, and ancillary charges related to the transportation of grain".

Discussion – The definition of tariff contained in Section 34 includes conditions of carriage. Since conditions of carriage are an integral part of the rates they should be treated together and subject to review by the CTC.

– The ancillary charges provide the railways with an opportunity to extract additional funds from grain shippers for the movement of grain. To ensure these charges are not abused, they should be included for consideration under the various provisions of these Sections.

Sections 48-49 – Joint Line Rates

Amendment – Delete Sections 48 and 49 which allow the railways to publish joint line rates.

Discussion – Section 48 permits the railways to charge higher rates in respect of joint line movements. This provision should not be implemented. Acceptance of higher joint line rates works against the principle of port parity.

Where the cost of the additional switch is not offset by savings elsewhere in the rail operation, Section 284 of the Railway Act is sufficiently powerful to alleviate the problem.

Most costs are being averaged. There is no reason why joint line movements require special treatment.

PART III

GOVERNMENT PAYMENTS

Clause 54(1) – Cumulative government share of the cost change.

Amendment – Delete reference to 31.1 million tonnes.

Discussion – The 31.1 million tonne "cap" contradicts the intent of the Act to encourage expansion of grain exports. The imposition of the "cap" serves to erode the producer's Crow Benefit and discourage increased production. At a time when competing countries are increasing their assistance to their agricultural sector Canada is taking steps to reduce its support.

Clause 54(1) – Maximum shipper share of the rate of cost change.

Amendment – Shippers' share of the rate of cost change should be limited to 4.5 percent in respect of 1986-87 and subsequent years.

Discussion – Railways are assured recovery of their costs. The trade is assured remuneration for all expenses they incur. The Government of Canada is protected by a set "Crow Benefit" amount and the initial inflation points. It is only the farmer who is left exposed. It is not unreasonable to offer the farmer protection against an extra 1.5% inflation.

Clause 54(3) and 54(4)

Amendment – Delete these clauses.

Discussion – These two sections allow the Federal Government to adjust downward their share of the "cumulative share of the cost change per tonne".

– The conditions under which this will be done are not specified.

Section 55 Amendment – This section should be amended to incorporate the Double 80 proposal described in the brief.

Discussion – Double 80 offers a compromise which meets the needs of Alberta's farm organizations.

Section 56 – CN Adjustment

Amendment – Supplement this section with a clause which states that CN must first demonstrate that for all grain transported they will not be adequately compensated and then demonstrate the need for additional compensation taking into account all factors affecting costs, not just additional mileage.

– Delete Section 56(4).

Discussion – This Section of Bill C-155 contains a provision for CN to receive additional funds to compensate for the greater distance to Prince Rupert, Ridley Island, and Churchill. The greater distance does not automatically lead to higher costs, particularly in the cases of Prince Rupert and Ridley Island. Given the available capacity on this route and very little port congestion, it is possible that car cycles and yard costs savings could offset the longer distance. In a recent study Carl Snavely identified the additional compensation required by CN as $3.2 million. This is considerably less than the $14 million contained in the legislation.

Limitation On Shipper Share of Cost

Amendment – Appendix II describes an alternative procedure limiting the increase in costs imposed on the shipper by employing a value-of-service concept.

Discussion – The Appendix outlines an alternative approach to constructing a "safety net" for grain farmers. This approach ties the compensation received by the railways to changes in the price of grain. Such an approach has a number of advantages:

(1) The railway rates will vary.

(2) If the fixed per cent limit persists over time, it could cause the rate to become noncompensatory again. This creates a long term problem for the livestock sector and removes the farmers' incentive to improve grain transportation efficiency.

The approach advocated in Appendix II avoids the problem of "cross-over" which occurs because grain prices have historically risen at slower rates than have railway costs.

(3) It is able to take effect immediately.

(4) This approach does not require additional funds and thus opens opportunities to use these funds to achieve other objectives. For example, the reinstatement and continuance of the Agricultural Adjustment payment.

(5) The cost of capital used in determining the "Crow Benefit" included compensation for "business risk". That is, the risk of changing revenues with market conditions that occurs with value of service pricing. Rates set under the provision of this Act are strictly cost-plus and consequently protect the railways from the major element of business risk (volume is relatively stable). The proposal contained in the Appendix exposes the railways to the business risk for which they are being compensated.

COMMENTS AND CONCERNS

1. Review

(a) 1985/86 is too soon to conduct a review. There will not have been sufficient time to assess the impacts of the proposed changes.

(b) There is doubt that the farmer will be able to pay greater freight rates, therefore the Bill should limit the farmers' share of future rail cost increases to 4.5% and future reviews should determine whether it should be increased.

(c) Many of the issues identified do not have to wait for a legislated review, nor should the review be limited to the Western Grain Transportation Act. Priority tasks such as the definition of the "shipper" and the rate incentive issues could be addressed immediately.

2. Rate Structure

(a) Relationships to Costs

An examination of the proposed rate structure indicates that there is no taper in the rate structure over distance. In fact the proposed structure provides a greater constant rate of increase between mileage blocks for distances over 1200 miles than for distances less than 1200 miles. This occurrence is contrary to the normal structure of freight rates over distance and does not accurately reflect incremental railway costs. As this structure is adjusted over time with the successive application of an index to each rate level, greater discrepancies between long and short haul shippers will occur. Consequently, the greatest impact of this inaccurate rate base structure will be on farmers in the northern part of Alberta.

(b) Appeals to Changes in Rates

There is a need to both streamline and supplement the rate appeal mechanisms. The need for seven months notice is too inflexible. If the rate concession adversely affects a third party, then that affected party may appeal under S.23 of the National Transportation Act.

(c) Rate Arbitration

While the proposed regulations appear to provide protection for third parties affected by a lower rate, there is no provision to protect the "shipper" who is captive to the railway. A process of **rate arbitration** would protect the shippers as well as provide a forum to interpret agreements where disputes arise.

(d) Rate Changes

The review should give consideration to the "productivity sharing" problem associated with Section 45 which allows the railways to publish lower rates. As it is now structured there is little incentive for the railways to offer lower rates. The periodic recosting of the rate base effectively takes the cost savings resulting from the elevator/railway improvements and averages them over all farmers and all delivery points. Consequently, the railways are able to only offer short term rate concessions.

3. Branch Line Subsidies

Section 64 amends Section 258 of the Railway Act. This change may be deficient.
There may be some branch lines currently subsidized under S.258 of the Railway Act which do not meet the "grain dependent line" criteria but still have sufficiently low traffic density to qualify for a subsidy. In particular the light density lines used for operations other than the movement of grain would be affected.

4. Omissions

The Act is silent on the federal government's commitment to branch line rehabilitation and hopper car supply. Who is responsible for these costs upon expiration of the Federal commitment which currently only goes to 1990 for rehabilitation and 1986 for hopper cars?

5. Performance Objectives

A properly functioning marketplace is the best system for rewarding good performance and penalizing poor performance. There should be a greater role for the marketplace than envisioned in the Act. Two aspects of the proposed legislation cause concern. First, the system of awards and sanctions has a punitive connotation. In order to implement the program, the problems of overlapping regulatory jurisdictions and the vaguely defined authority and responsibility of participants needs to be resolved.

Second, the provisions to allow lower rates are insufficient to provide an incentive toward long term efficiency.

Appendix II

VALUE OF SERVICE PRICING APPLIED TO RAIL FREIGHT RATES FOR GRAIN

Concept of a Safety Net

To protect against financially burdensome freight rates, the federal government has indicated a willingness to consider a "safety net" provision which would limit farmers' exposure to the risk of higher freight costs vis-a-vis grain returns. The federal proposal has been to limit freight charges to some percentage of a weighted average price for a 'basket' of western grains.

For any proposal to adequately protect producers from burdensome freight rates, it must meet certain criteria.

1. It must be timely in its response to changing market conditions that would affect a farmer's ability to pay.
2. It must not interfere with the principles or objectives of reducing disincentives and distortions arising from the present rate structure.
3. It must provide farmers with long term protection.
4. It must ensure the railways are compensated for the variable costs of moving grain.

The proposal presented here meets these criteria.

Value-of-Service Pricing Concept Applied to Grain

Value-of-Service Pricing would protect farmers from rising freight rates in times of declining grain prices by having the freight charges collected by the railways reflect the value of the service being provided to the shipper. Essentially, this means that freight rates move in the same direction as grain prices. In years where grain prices drop dramatically the rail rate assessed the producer would decline, but not below the variable cost of the movement. Conversely, in years where grain prices are high the rates would reflect the full contribution to constant costs (20%) allowed the railways.

a) **value-of-service pricing**: In normal commercial negotiations of rates with shippers captive to rail, rates are set on the basis of 'ability to pay' or 'value-of-service'. Rates assessed by the railways will vary over time, rising when shippers can afford to pay and falling (or remaining stable) when they can not afford increases. This proposal deviates from the value-of-service principle in that it recognizes that grain shippers are captive to rail, therefore the upper limit on rates is set at 20 percent above long run variable cost.

b) **railway compensation**: value-of-service pricing provides the railways with adequate compensation for grain movement. The cost of capital used in the determination of the "Crow Benefit" included compensation for "business risk". This is the risk of changing revenues with market conditions that occurs with value-of-service pricing as described above. Rates set under the provision of this Act are strictly cost-plus, consequently they protect the railways from the major element of business risk. Value-of-service pricing exposes the railways to the normal business risks for which they will be compensated.

c) **methodology**: Included in the new grain freight rate structure is a proposed 20 percent contribution to railway constant costs. Part of this contribution (8 percentage points) is retained by the federal government to ensure performance; the balance (12 percentage points) is paid to the railway. It is proposed that the 12 percent be varied in order that rail freight rates reflect grain market conditions as indicated by grain prices.

The methodology would be as follows:

1. Prior to the beginning of a crop year, the Canadian Transport Commission would review and agree upon the railways' cost estimates. At this time the full contribution to constant costs would be included so as to get an estimate of the base rate level.
2. A projection of the next year's weighted average grain price would then be determined.
3. The change in the average grain price would then be correlated to the contribution to constant costs, i.e., from a minimum of 0 to a maximum 12 percentage points of the 20 percent contribution to constant costs.

From the railways' perspective, their revenues per tonne may be reduced from time to time. However, at a minimum, their variable costs will always be covered in full and there will still remain an 8 percent contribution that they can earn based on performance criteria.

Advantages

1. The railway rates will vary with the farmer's ability to pay.
2. Value-of-service pricing avoids the problem which occurs because grain prices have historically risen at rates considerably lower than freight rates. A rate limit fixed as a percentage of the price of grain may persist over time, causing the rate to become noncompensatory. This recreates the distortion to the livestock sector and removes the farmers' incentive to improve grain transportation efficiency.
3. Value-of-service pricing could take effect immediately.
4. Value-of-service pricing approach does not require additional funds.
5. Value-of-service pricing prevents the railways from earning undeserved profits for transporting grain.